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AGENCY IMPUTED FROM "COURSE OF BUSINESS."

It is generally agreed among writers on the subject that no one is bound by the acts of his agent except upon the theory either of actual authority (express or implied, prior or by ratification) or of estoppel. If the principal has expressly authorized the agent's act, of course he is bound by it. If he has given general instructions to the agent, which instructions by natural, customary or legal implication authorize the act, he is likewise bound by it. If, after the act, he is informed of it and approves of it, the ratification is equivalent to a prior express authority. If it is afterwards brought to his attention and he acquiesces, his acquiescence constitutes a ratification equivalent to a prior implied authority. Furthermore, one may be charged with legal responsibility for the act of another upon the theory of estoppel, although he did not authorize it either expressly or by implication, but even forbade it. The principal may have made some direct representation upon which the party dealing with his agent has relied. Thus, in the common case of general agency he may have clothed the agent with an authority that by ordinary custom embraces a multitude of acts, but has privately forbidden him to do some of those acts. If the agent nevertheless does them, he is responsible to anybody who knew of and relied upon the general agency and did not know of the special instructions. And we have the other cases, also common, which Mr. Ewart has classified under the general title of assisted misrepresentation. "If the ostensible agent is the one who makes the representation of authority, and the supposed principal has merely assisted that representation—done that which has made it credible—he will be as much estopped as if he has himself made the representation."[1]

When there is no actual authority, either prior or by ratification, the writers have generally agreed that there must be an actual estoppel. The person seeking to hold the principal responsible upon the theory of ostensible agency,

[1] Ewart on Estoppel, p. 473.

in the absence of actual authority, must show that he knew of the acts or omissions of the principal upon which the latter's responsibility is claimed to be predicated, and "relied in good faith and prudently upon the appearance of authority thus created."[1]

The third party "must show that the agency did exist, and that the agent had the authority he assumed to exercise, or otherwise that the principal is estopped from disputing it."[2] As was said by Lord Justice James, "Nobody ought to be estopped from averring the truth or asserting a just demand unless by his acts or words or neglect his now averring the truth or asserting the demand would work some wrong to some other person who has been induced to do something, or to abstain from doing something, by reason of what he had said or done, or omitted to say or do."[3] Mr. Ewart adds "Change of position to misrepresentation bears somewhat the same relation as consideration to contract."[4] Thus in the case of a general agency, the secret restrictions of which the agent has violated, the party dealing with the agent has no ground for complaint against the principal if he did not know of the existence of the general agency, but relied entirely upon the agent's statement that he was authorized to represent the principal in that particular transaction. "Apparent authority operates only by way of estoppel, and can take the place of real authority only when some person has acted upon the appearances."[5]

Within the last few years, however, there has been a tendency in certain of our courts to establish a new kind of agency, where there is no authority and no estoppel, namely, *an agency imputed from "course of business."* A's agent goes to B, introduces himself, informs B that he is

[1] Huffcut on Agency, § 103; See also §§ 9, 53, 106; Bowstead on Agency, Art. 85.

[2] Lord Cranworth in Pole *v.* Leask (1862) 33 L. J. Ch. 155, 162 (H. L.)

[3] *Ex parte* Adamson (1878) L. R. 8 Ch. Div. 807, 817–8.

[4] Ewart on Estoppel, p. 131; See Jackson Paper Co. *v.* Commercial Bank (1902) 199 Ill. 151, 158–9 and auth. cit.

[5] People *v.* Bank of North America (1879) 75 N. Y. 547, 561. This is the principle of the famous Schuyler case, where Judge Davis said "The doctrine of implied agency, when it arises out of negligence, I think has its true basis in the principle of estoppel *in pais.*" N. Y. & N. H. R. R. Co. *v.* Schuyler (1865) 34 N. Y., at p. 53.

such agent, and says that his authority includes the pledging of his principal's credit in a certain way. B believes him, makes no further inquiry, and gives credit. The agent had no such authority in fact. B sues A. A proves in defense that while the man was his agent for other purposes there was no authority for this transaction. B then proves that the agent had done practically the same thing several times before with other parties. A proves in rejoinder that he himself had never heard of these transactions, and that B never heard of them either, and of course was not induced by them to give the credit; so that there was no actual authority and no estoppel, and the case does not come within any of the old recognized classes of agency. B however says that A was negligent; that, while he did not know of these particular transactions of his agent, he ought to have known them if he had exercised sufficient diligence; and that he should therefore stand the loss as a kind of penalty for his insufficient watchfulness.

The new doctrine is being developed in litigations arising out of defalcations by officers of corporations, and particularly of banks, for the daily transactions of banks are so large that strict auditing is difficult. The propositions are familiar that a bank cashier, for instance, has general power to certify checks upon his bank or to issue drafts upon other banks; that his official signature is equivalent to the signature of his bank; that, however, his position as cashier gives him no general authority to certify checks or issue bank drafts for his own benefit; and that his own name as drawer of the check or payee of the bank draft is a "danger signal", putting all takers upon notice that he is probably acting for his own benefit and therefore not binding the bank.[1] Cashiers do, however, often sign for their own benefit. For small amounts they do it to save trouble; for large amounts they probably sometimes do it for the same reason, and sometimes also for purposes of embezzlement. The signatures of drafts and certificates for small

[1] Park Hotel Co. *v.* Fourth Natl. Bank (1898) 86 Fed. at p. 744 and cas. cit. As to the particular case of bank drafts an exception has been established in the State of New York by Goshen Bank *v.* The State (1894) 141 N. Y. 379, a case much discussed, distinguished and criticised, and not as yet followed elsewhere, and which may not be authority even here except after the bank has recognized the draft by paying it.

amounts are not carefully scrutinized by the cashier's superiors. Such minute scrutiny in large establishments would be impracticable. Occasionally, of course, there is such loose management that similar drafts for large amounts pass unnoticed. At last, not infrequently, embezzlement follows. The bank goes into the hands of a receiver, and the cashier is found to have depleted its funds by checking them out for margins to his brokers. When the receiver sues to recover the money, the defense is based on the fact that the cashier had done the same thing several times before.

This development of the doctrine of "course of business" seems to begin in 1884 with certain *dicta* in Martin *v.* Webb,[1] where the court, speaking of the duties of directors, says "That which they ought, by proper diligence, to have known as to the general course of business in the bank, they may be presumed to have known in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business." The opinion contains the cautionary statement that its "general expressions" should be "interpreted by the facts of this case"; and thus interpreted, the opinion clearly refers to dealings with persons entitled to assert an estoppel. In Hanover Bank *v.* American Dock and Trust Co.,[2] decided in 1896, the New York Court of Appeals quoted this remark and seemed to go further, as in the absence of any estoppel they said as to the directors' knowledge of prior similar transactions "while it does not appear that they actually knew of these transactions, it was a question of fact for the jury to say whether they ought not to have known, under all the circumstances, as their ignorance was no excuse, unless they were reasonably diligent in supervising the method and details of conducting the business under their control"; but at the close of the opinion they make the case turn upon the jury's plain right, in the absence of any evidence to the contrary, to infer actual knowledge of whatever it was the duty of the directors to know. It remained for sometime doubtful here in New York whether the fact that the directors "ought to have known" of what their employee was doing was, in the

[1] (1884) 110 U. S. 7. [2] (1896) 148 N. Y. 612.

absence of an estoppel, to be given greater weight than as evidence tending to show that they did know of it, and therefore presumably authorized or ratified it;[1] but that doubt seems now to have been resolved by the case of Campbell *v.* Upton,[2] affirming without opinion a decision of the lower courts, which seems to have based a bank's liability for unauthorized acts of the cashier squarely upon the directors' negligence in failing to find out that he had committed similar unauthorized acts before. The "course of business" thus established was not used as presumptive evidence of knowledge on the part of the directors. On the contrary, it had been expressly found by the trial judge that all the directors were ignorant of it. There has never been a clear discussion of the distinction in New York; and a decision of the New Jersey Court of Errors and Appeals upon another transaction of this same cashier, while the opinion points in the same direction, leaves the question in doubt in that State.[3] Massachusetts would doubtless vigorously oppose the doctrine.[4] In other States it has been little discussed. In the Federal courts it was formerly assumed that any presumption from the past course of business of a corporate officer might be rebutted by affirmative proof of lack of authority, in the absence of special circumstances making the presumption conclusive—that is, as I understand it, of an estoppel;[5] but recently there has been a tendency toward what may now be called the New York rule, and in a case which has gone twice to the Circuit Court of Appeals for the Second Circuit, the theory of agency by "course of business" was sustained in opinions from which it is not entirely clear whether or not the court intended to go to the full length of sustaining it where ignorance on the part of the directors affirmatively appears; but after a full argument in the Supreme Court the decision was reversed upon other grounds.[6]

As this new doctrine has not yet made its way into the

[1] Corn Exchange Bank *v.* American Dock and Trust Co. (1900) 163 N. Y. 332.

[2] (1902) 171 N. Y. 644.

[3] Campbell *v.* Manufacturers' Natl. Bank (1902) 67 N. J. L. 301.

[4] Murray *v.* Nelson Lumber Co. (1886) 143 Mass. 250.

[5] Mining Co. *v.* Anglo-Californian Bank (1881) 104 U. S. 192, 195.

[6] Gale *v.* Chase Natl. Bank (1900) 104 Fed. 214; (1901) 108 Fed. 987; S. C. *sub. nom.* Rankin *v.* Chase Natl. Bank (1903) 188 U. S. 557.

law outside the State of New York, it is properly open to analysis and discussion. Historically, as I have pointed out, it seems to be growing up by an application of *obiter dicta* to situations which they seem to fit, but for which they were not intended. Theoretically, it seems to rest upon no recognized legal reasoning. Practically, while doubtless meant to cast a loss upon that one of two innocent parties who is the more responsible for the situation which the agent has created, it seems more commonly to have had the effect of doing comparative injustice. For the question more commonly arises upon an unauthorized draft signed by an embezzling bank cashier. The person who sues upon such a draft, basing his claim upon a prior course of action of which he had had no knowledge or information when he gave credit to the cashier, is really trying to establish a liability of a penal nature. There is nothing contractual about it. It is not even in the nature of an action for negligence, since his own greater negligence in taking, without inquiry, paper presumptively illegal, has contributed to the injury.[1] He is seeking to penalize the bank because it was laggard in discovering the cashier's course of irregularities, and thus failed to discharge him before he committed the particular irregularity in question. The omission so penalized, however, was an omission of the directors or of their auditing committee, while the case generally comes into court after the bank has failed, so that the persons actually penalized are the unfortunate creditors or depositors, who are asked to contribute margins for the cashier's broker or compensation for those who encouraged his extravagance. Penal actions are not encouraged by the law. Whether this new kind of penal action should be established is at best doubtful. In one of the most recent cases Judge Lacombe, while expressing the opinion that the doctrine is now established as an exception to the general principle that one dealing with a cashier outside of the usual limits of a cashier's authority is put upon inquiry, says: "It would have been a most wholesome thing if that principle had never been qualified at all"; and again that "the courts seem rather to have overlooked the circumstance that in the one case the unfortunate stockholders and creditors had

[1] New York Iron Mine *v.* Negaunee Bank (1878) 39 Mich. 644, 656.

no means of knowing that their officers were dishonest or their directors negligent, until the trouble had occurred; whereas the creditors who received the consideration would always be advised by mere inspection of the face of the draft that something crooked was to be anticipated, that something was not right."[1]

Still another question arises when the agent is a bank cashier or other corporate officer, when the negligence is the negligence of his directors, and when the act under consideration was the use of the corporate funds to pay his own debt. Let it be assumed that the plaintiff in the action against the bank or its receiver had been a creditor of the cashier, who had taken in payment of the indebtedness a draft signed by the cashier with his official signature, drawn upon a correspondent bank, with the plaintiff as payee. He relies upon a long series of previous drafts of a similar nature, as constituting a "course of business." For present purposes it may be assumed that he knew of these previous drafts, and that they had been honored by the bank, before he took the draft in suit, and relied upon them in giving credit; even that the previous drafts, although illegal, had been known also to the directors of the bank, and that they had merely reprimanded the cashier or, in view of his replacement of the money, overlooked his offence. Thus all the elements of an estoppel and all the elements of a ratification are present, provided the directors had authority to ratify. Had they such authority? That is one of the questions recently much argued and still unsettled. There can be no estoppel unless the plaintiff had the right to infer, as he did infer, that the directors had ratified the "course of business" and bound the bank by that ratification. There can be no ratification of a "course of business" by a man who could not previously have authorized it. The maxim is *omnis ratihabitio retrotrahitur, et priori mandato equiparatur.*[2] "A ratification can have no greater force than a previous authority."[3] Can the directors of a bank adopt a by-law giving the cashier general power to issue bank paper for his own benefit? New York impliedly so holds in the

[1] Campbell *v.* National Broadway Bank, October, 1902, unreported.

[2] Fleckner *v.* United States Bank (1823) 8 Wheat. 338, 363.

[3] Daviess County *v.* Dickinson (1886) 117 U. S. 657, 665.

cases above referred to, but I venture to think that the weight of argument is to the contrary. Directors have not unlimited powers, and in particular, being themselves trustees or agents,[1] they cannot delegate unlimited powers to one of their own number or to any other officer of the corporation. A general power to the cashier to sign bank drafts to his own order or that of his creditors and use them for his private purposes cannot possibly be for the benefit of the bank (since it is perfectly feasible for some other officer to be given the necessary authority when signatures for the cashier's individual purposes are desired), while such authority leads to temptation and often to crime. It was held in Anderson *v.* Kissam,[2] that a general usage of all the banks of New York City, recognizing a general authority in bank cashiers to sign bank paper for their individual purposes, was contrary to public policy and illegal. If this general usage is illegal, certainly a corresponding special usage of a single bank, even if established by a vote of the directors, is equally illegal. "There cannot be a course of dealing in reference to illegal acts."[3] A rule of public policy cannot be evaded by any mere form. Hence if, as has been often said,[4] the rule prohibiting an agent from contracting on behalf of his principal when he is individually interested on the other side, is a rule of public policy, it cannot be evaded under cover of a prior authority or subsequent ratification given by any other agent of the same principal.[5] Of course, the directors can by special action ratify prior illegal acts upon restitution, or because they turn out to benefit the company; but the existence of this power can not entitle any one to infer

[1] Mr. Justice Strong in Bedford R. R. Co. *v.* Bowser (1864) 48 Pa. St. 29, 37.

[2] (1888) 35 Fed. 699, 701, 703, reversed on another point in 145 U. S. 435, and then compromised.

[3] Mercantile Insurance Co. *v.* Hope Insurance Co. (1880) 8 Mo. App. 408, 411; see also Lee *v.* Smith (1884) 84 Mo. 304, 310; Iowa Bank *v.* Black (1894) 91 Iowa 490, 496.

[4] Wardell *v.* Union Pacific R. R. Co. (1877) 4 Dill. 330, 335, (aff. 103 U. S. 651); West *v.* Camden (1890) 135 U. S. 507, 521; Lamson *v.* Beard (1899) 94 Fed. 30, 43-4.

[5] This view was taken by one of the New Jersey Judges in Campbell *v.* Manufacturers' Natl. Bank, *supra*. The point has been recently at least three times argued in the United States Supreme Court, but left undecided.

that they have given authority to repeat the acts in future.

Whether the prior illegal transactions of the agents are offered in evidence for the purpose of affording a presumption that his principal had ratified them, or for the broader purpose of penalizing the principal for his negligence in not discovering these acts, interesting questions have arisen as to the number and kinds of prior instances which would be sufficient to take the case to the jury. If the draft in the suit is for $10,000, of course, neither one prior draft for that amount nor a dozen prior drafts for $1 would be sufficient to constitute the necessary "course of business." A Federal Court of Appeals, in a recent case, reversed a judgment on the ground that a few checks for a few hundred dollars each were not sufficient to sustain presumptively a subsequent check for several thousand dollars.[1] The New York Court of Appeals on the other hand has permitted a jury to find a verdict against a corporation upon a warehouse certificate unlawfully signed by its president for his own benefit, based upon two similar receipts signed by him ten years previously, and three similar receipts signed by him five years previously, while holding a different office in the same corporation.[2]

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[1] Gale *v.* Chase Natl. Bank, *supra.*

[2] Hanover Bank *v.* American Dock & Trust Co., *supra*; but see Farmers' Bank *v.* Noxon (1871) 45 N. Y. 762, 765; James Reynolds Co. *v.* Merchants' Natl. Bank (1900) 55 App. Div. 1.